OMB Circular No. A-123 Starting the Process

"Implementing a Sustainable and Effective Control and Compliance Program."

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A-123 Starting the Process Briefing Topics

? **What is OMB A-123 all about?**
- **Objectives & Standards**

? **Why is A-123 important to you?**
- **Appendix A - New Financial Reporting**
- **Other Appendixes include:**
  - o **Appendix B Bank Card**
  - o **Appendix C Improper Payments … more to follow**

? **What are the steps of the A-123 Process?**
- **Step I**   **- Planning**
- **Step II**   **- Evaluating Entity Level Controls**
- **Step III**   **- Evaluating Process Level Controls**
- **Step IV**   **- Testing Transaction Level Controls**
- **Step V**   **- Concluding, Correcting, and Reporting**
- **Step VI**   **- Sustaining the Program Long Term**

? **What is the result and benefit?**
- **Compliance Program**
- **Cross Cutting and Collaboration**
- **Return on Investment**

A-123 Starting the Process
What is A-123?

"OMB Circular No. A-123 **defines management's responsibility for internal control**."

The three **objectives** of internal control:

? Effectiveness and efficiency of operations,

? Reliability of financial reporting, and

? Compliance with applicable laws and regulations.

Management is responsible for developing and maintaining internal control activities that comply with the following **standards** to meet the above objectives:

? Control Environment,

? Risk Assessment,

? Control Activities,

? Information, Communications, Monitoring

A-123 Starting the Process
Why is A-123 Important?

It provides managers guidance to develop, establish and monitor the program.

? OMB A-123 requires **changes to existing reporting** requirements, including some **new requirements** over financial reporting.

? Revised OMB A-123 Appendix A

Addresses **assessing, documenting, and reporting on the effectiveness** of internal control over financial reporting

A-123 – Starting the Process
New Financial Reporting

OMB A-123 requires **changes to existing reporting** requirements, including some **new requirements over financial reporting**:
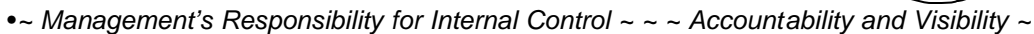
? **Defines scope** of assessing and documenting internal control over financial reporting

? **Defines materiality**

? **Defines process for assessing** internal control over financial reporting at:

- Entity level
- Process level,
- Transaction level / Application level

? **Requires documentation of controls** over financial reporting

? **Requires documentation of the assessment process** of controls over financial reporting

? **Requires an assurance statement "as of June 30"**

A-123 – Starting the Process
Revised A-123 Appendix A

- **Internal Control Standards** follow Committee of Sponsoring Organizations (COSO) Framework
  - Document control environment
  - Perform risk assessment
- **Management's Documentation Requirements**
  - Document flow of transactions for key business processes
  - Document key controls related to financial statement assertions
- **Test Control Design and Operation**
  - Document and assess entity-wide controls and transaction-level controls
- **Management's Assertion**
  - Based on effectiveness of internal control structure, systems, and control environment

A-123 – Starting the Process
Process Overview

A.

Step 1
Planning

↓

Establish Senior Management
Council, Senior Assessment
Team, and Organizational
Structure

↓

Develop a Top-Down
Focus

↓

Determine Scope
(Identify Significant
Reports)

↓

Determine Materiality

↓

Determine Key
Processes

↓

Risk Assessment

↓

Integrate &
Coordinate Review
Activities

↓

Plan Monitoring &
Testing Approach

↓

Standardize
Documentation

B.

Step II
Evaluating Entity
Level Controls

↓

Document & Assess
Entity-wide Controls

C.

Step III
Evaluating Process
Level Controls

↓

Understand Key
Financial Reporting
Processes

Identify Key Internal
Controls Over
Financial Reporting

Identify General IT
Controls

Assess the
Effectiveness
of the Design of
Controls

Assess the
Effectiveness
of the Design of IT
Controls

Designed
Effectively? **YES**

NO

E.

Step IV
Testing
Transaction
Level Controls

↓

Test & Document the
Controls Operating
Effectiveness

D, F, & G.

Step V
Concluding,
Correcting, and
Reporting

Is the Control
Effective? **YES**

NO

Is there a
Compensating
Control? **YES**

NO

Is Control
Gap
a Material
Weakness? **YES**

NO

Report
Management's
Assurance

Report Internally

Report
Material
Weakness

Assurance
Statement is
Unqualified

Develop
Corrective
Action Plans

Assurance
Statement is
Qualified

Report
Assurance as
Of 6/30 &
Corrective
Action, if
Necessary

Update Status
As of 9/30 –
Corrected Prior
to year-end

Annual PAR
Issued with
Assurance
Statement &
any Material
Weaknesses

•~ *Management's Responsibility for Internal Control ~ ~ ~ Accountability and Visibility ~*

A-123 – Starting the Process
Step I, II, III- Planning and Inventory

1. Establish **Senior Assessment Team** responsible for:
   - Determining scope and approach of the assessment process
   - Communicating the process throughout the agency
   - Ensuring resources are provided and staff are trained
   - Analyzing the results and testing the assessment
   - Reporting assessment results and implementing corrections
2. Determine **overall approach** – top-down
3. Determine **scope, breadth, and depth of financial reporting**
4. Determine **materiality** – quantitative and qualitative
5. Determine **key processes** underlying material line items
6. Assemble an **integrated internal control framework** to maximize existing evaluations of internal controls over financial reporting
7. **Financial Reporting Assertions** – commonly referred to as PERCV:
   - **P**resentation and Disclosure
   - **E**xistence or Occurrence
   - **R**ights and Obligations
   - **C**ompleteness
   - **V**aluation or Allocations
8. Perform **Risk Assessment** of line items for each assertion
9. Prepare the **testing plan**
10. **Document key processes and internal controls** over those processes
11. **Document entire Senior Assessment Team process**, including all key decisions

A-123 – Starting the Process
<u>Step IV- Document, Test, Remediate</u>

1. **Isolate and document key controls** over financial reporting

   Control documentation includes all five internal control components (control environment, risk assessment, control activities, information and communication, and monitoring), including supporting processes (manual and automated) and transaction flows.

2. **Test key controls**
   - Inquiry – asking if controls are in place and functioning
   - Inspection – looking at evidence that controls are functioning
   - Observation – observing control procedures in operation
   - Re-performing – duplicating the control procedure

3. **Identify control gaps**
   - Deficiency in control design
   - Deficiency in control operation

4. If the key control is not operating as designed, or the design is flawed, **establish a remediation or corrective action plan.**

5. **Independently validate** and verify the effectiveness of the remediate procedures.

6. **Design effective monitoring procedures** to sustain a sound and efficient internal control environment, and minimize future control assurance efforts.

A-123 – Starting the Process
Step V- Conclude and Report

A properly designed and implemented monitoring process will result in strengthened controls and less costly assurance reporting in subsequent years.

1.Conclude on Effectiveness
- <u>Internal Control Deficiency</u> – simple, significant, material
- <u>Reportable Condition</u> – more than a remote likelihood of a greater than inconsequential misstatement
- <u>Material Weakness</u> – more than a remote likelihood of a material misstatement

2.Report on Results
- <u>Internal reporting</u>
  - o Senior Assessment Team decides what weaknesses get reported and tracked

<u>External reporting</u>
  - o Statement of assurance included, as of June 30th, is included in the Performance and Accountability Report (PAR)
  - o Statement classified as Unqualified, Qualified, or No Assurance
  - o Material weaknesses and reportable conditions require corrective action plans

A-123 – Starting the Process
"Step VI"- Sustain

Sustain continuous monitoring to ensure that key controls are properly functioning and that systems and processes are free of material errors.

Continuous monitoring:

- Is a measurable, effective, and efficient process for testing, remediation, monitoring, and reporting of controls;

- Integrates with existing financial and internal control monitoring and reporting processes;

- Assumes designated process owners and participants, with clearly articulated roles and responsibilities and assigned accountability; and

- Must be adaptable, flexible, and able to respond to organizational, legislative, and regulatory changes.

A-123 – Starting the Process
Approach: <u>Coordinated Activities</u>

There are many **overlapping areas** and as such, the assessment of internal control over financial reporting should be **coordinated with other activities to avoid duplication of effort** with similar activities.

Examples of activities supporting the Assurance Statement:

- Tracking reporting **corrective actions** for material weaknesses and non-compliance issues;

- Assessing the effectiveness and efficiency of **program operations**;

- **IT security**;

- Monitoring compliance with **laws and regulations.**

A-123 – Starting the Process
Compliance Program Approach

1. One of the first steps toward a transforming compliance is to implement an **efficient compliance program**.
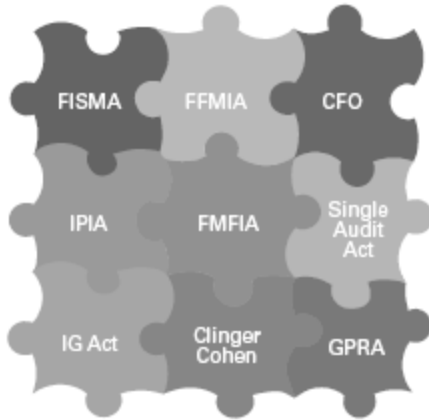
Integrating and aligning our organization-wide compliance requirements such as:
- Federal Managers' Financial Integrity Act (FMFIA)
- and Federal Information Security Management Act (FISMA)
- and Chief Financial Officer's Act

2. To the extent possible, the goal is to employ a **standardized methodology for data collection and data management**:
- Documentation standards (format, indexing, change control, and storage)
- Planning and documentation templates
- Questionnaires and work plans
- Automated tools

A-123 – Starting the Process
Approach: Cross-Cutting / Collaboration

Integrating Finance, Operations, and Compliance

- **Document Business Process and Outcomes**
- **Conduct Assessment and Gap Analysis**
- **Test and Assess for Continuous Improvement**

A-123

ISO:9001

What is ISO 9001 really all about? Many people believe that ISO 9001 is all about "managing quality." However, ISO 9001 is really all about increasing and standardizing the "quality of management". ISO achieves this through the following actions:

- Establish management commitment to the concept of continual improvement by "increasing the quality of management."
- Identify **key internal processes and the intra and inter-organizational dependencies that influence their outcome**.
- Identify **critical steps within each process and the influences that result in variances in their outcome**.
- Identify/develop and incorporate applicable proven best practices to reduce/eliminate the variance in key steps and processes.
- Communicate and provide training on these best practices.
- **Establish internal and external measurement, analysis, and process improvement mechanisms** that ensure continuous improvement in the quality of management.
- Establish clear lines of management responsibility and accountability for the "quality of management".
- Reinforce ISO 9001 concepts to inculcate them into the fabric of the organizational culture.
- Perform internal audits to confirm the establishment of an ISO 9001 organizational culture. **Gap analysis used to fine tune continuous improvement process**.
- Seek out an independent ISO audit as a final step to ISO registration.

OMB Circular A-123, Management's Responsibility for Internal Control: OMB Circular A-123 defines management's responsibility and accountability for internal control in federal agencies. The policy changes in this circular are intended to strengthen the requirements for conducting management's assessment of internal control over financial reporting. The circular also emphasizes the need for agencies to integrate and coordinate internal control assessments with other internal control-related activities.

Internal Control over Financial Reporting: Specifically, OMB Circular A-123, Appendix A sets forth a process agency management must follow to document, assess, test and report on the effectiveness of internal controls over financial reporting. This methodology requires agency management to:
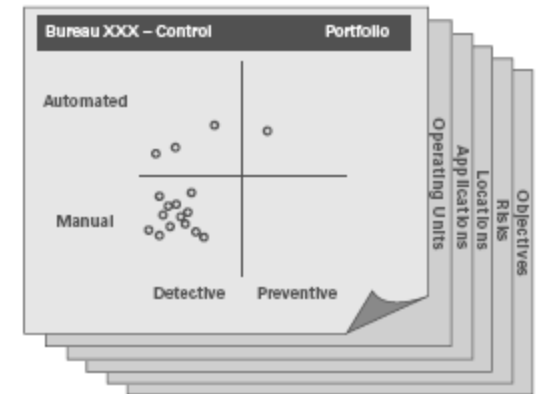
- **Establish a Senior Assessment Team** of senior executives that derives its authority and support from the agency head or the Chief Financial Officer (CFO). The SAT provides oversight for all aspects of the assessment process.
- **Evaluate internal control at the entity level** to include the five components for internal control established by the Government Accountability Office (GAO).
  1. Control Environment
  2. Risk Assessment
  3. Control Activities
  4. Information and Communication
  5. Monitoring
- Evaluate internal control at the **process, transaction, and application level** by:
  1. Determining **key business processes**, significant accounts
  2. Identifying and evaluating major classes of transactions
  3. Understanding the financial reporting process
  4. Understanding and **assessing control design**
  5. **Testing and assessing control effectiveness**.
- **Issue an overall assessment** of the design and operation of internal control over financial reporting as part of its annual Performance and Accountability Report (PAR).

~ Management's Responsibility for Internal Control ~ ~ ~ Accountability and Visibility ~

A-123 – Starting the Process
Approach: Deployment Concept

Deployment Strategy	Touch Points
ISO:9001	⬭
OMB A- 123	⬭
MEASURE & MONITORING PROG	⬭
OTHER INITIATIVES (e.g. ABC/M)	⬭

ILLUSTRATIVE

Bureau XXX – Control Portfolio

Automated

Manual

Detective   Preventive

Operating Units | Applications | Locations | Risks | Objectives

Acquisition Services
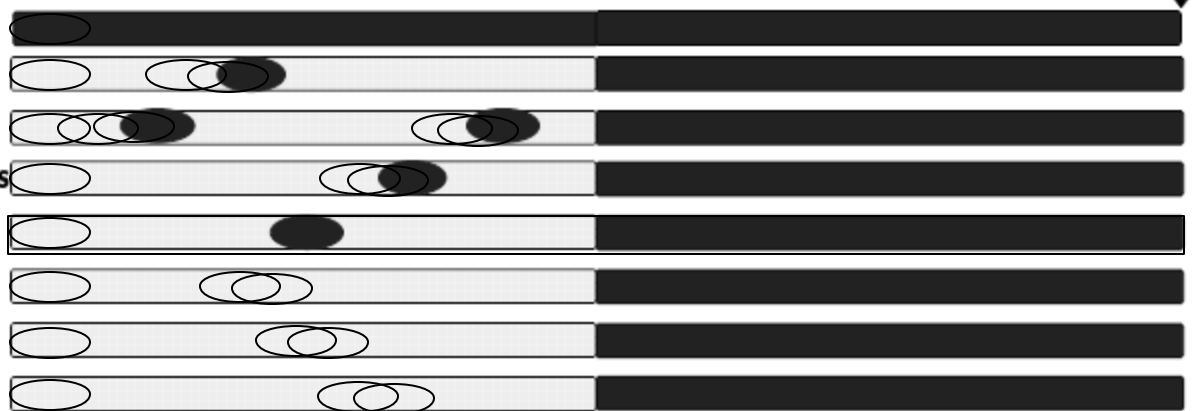
Human Capital

Information Technology

Federal Personnel, Payroll Systems & Services

Budget and Finance

Administrative Operations

Aviation Management

Appraisal Services

A-123 – Starting the Process
Sustainable Compliance Program

With a sustainable compliance program in place, you can analyze the control and plan their program improvement initiatives.

- Opportunities for improving controls, processes, and systems.
- Opportunities for reprogramming funds and streamlining processes.

Results:

- Enhanced quality of controls and processes
- Improved program effectiveness
- Evaluate how the compliance investment can help reduce the total cost of controls and improve performance, thereby creating a return on that investment by:

Action	Return on Investment
Standardizing and simplifying processes	To reduce redundancy and improve quality
Improving information flows and the integrity of managed	Thereby enhancing business decision-making
Enhancing employee utilization and mission focus as controls become more efficient and effective through appropriate use of technology	Leading to reductions in the ongoing cost of compliance as well as the cost of performance